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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 135

GEORGE R. DEMPSTER and FRANCES S. DEMPSTER, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (Pet. 23-29) is reported at 162 F. Supp. 585. The opinion of the Court of Appeals (Pet. 30-31) is reported at 265 F. 2d 666.

JURISDICTION

The judgment of the Court of Appeals was entered on April 29, 1959. (Pet. 35.) The petition for a writ of certiorari was filed on June 23, 1959. The juris-

diction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether a 1956 amendment to the Internal Revenue Code of 1939, providing that payments received after May 31, 1950, in return for a transfer of patent rights should be taxed as on a sale of capital assets, created a claim for the benefit of taxpayers who had previously paid income taxes on such payments as on regular income, so that the general six-year statute of limitations on claims against the United States applied.

2. Alternatively, whether the 1956 amendment impliedly extended the three year limitation on claiming tax refunds.

STATUTES INVOLVED

Internal Revenue Code of 1939:

> SEC. 117. CAPITAL GAINS AND LOSSES.
>
> * * * * *
>
> (q) [as added by Sec. 1 of the Act of June 29, 1956, c. 464, 70 Stat. 404] *Transfer of Patent Rights.*—
>
> (1) *General Rule.* — A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 6 months, regardless of whether or not payments in consideration of such transfer are—

(A) payable periodically over a period generally coterminous with the transferee's use of the patent, or

(B) contingent on the productivity, use, or disposition of the property transferred.

* * * *

(4) *Applicability.*—This subsection shall apply with respect to any amount received, or payment made, pursuant to a transfer described in paragraph (1) in any taxable year beginning after May 31, 1950, regardless of the taxable year in which such transfer occurred.

(26 U.S.C., Supp. V, Appendix, 117.)

SEC. 322. REFUNDS AND CREDITS.

* * * *

(b) *Limitation on Allowance.*—

(1) *Period of Limitation.* — Unless a claim for credit or refund is filed by the taxpayer within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, no credit or refund shall be allowed or made after the expiration of whichever of such periods expires the later. If no return is filed by the taxpayer, then no credit or refund shall be allowed or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer.

* * * *

(26 U.S.C. 322.)

28 U.S.C.:

SEC. 1346 [As amended by Sec. 1, Act of July 30, 1954, c. 648, 68 Stat. 589]. *United States as Defendant.*

(a) The district courts shall have original jurisdiction, concurrent with the Court of Claims, of:

(1) Any civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws;

* * * * *

SEC. 2401. *Time For Commencing Action Against United States.*

(a) Every civil action commenced against the United States shall be barred unless the complaint is filed within six years after the right of action first accrues. The action of any person under legal disability or beyond the seas at the time the claim accrues may be commenced within three years after the disability ceases.

* * * * *

STATEMENT

In the years 1951 and 1952, Mr. Dempster received certain sums as part consideration for the transfer to a corporation of all his rights in certain patents. On returns filed for those years, by March 15, 1952 and 1953, respectively, the taxpayers reported the

royalties so received as ordinary income and paid the tax due on that basis. (Pet. 23, 30.)

On September 11, 1956, the taxpayers filed claims for refund for the years involved alleging overpayments of tax for those years by virtue of an Act of Congress (Act of June 29, 1956, c. 464, 70 Stat. 404) which amended Section 117 of the Internal Revenue Code of 1939, by adding thereto subsection (q), *supra*, pp. 2-3. That subsection provides that (for the taxable years involved here) income received in consideration for a transfer of patent rights is to be treated as a long-term capital gain even though the payments are spread out over the life of the patent. The claims for refund were denied on July 9, 1957, and the taxpayers instituted suit for recovery of the taxes in question on August 23, 1957. (Pet. 23, 29, 30-31.)

The United States filed a motion to dismiss the complaint on the ground that the claims had not been filed within three years from the time the tax was paid, as required by Section 322(b)(1) of the Internal Revenue Code of 1939, *supra*, p. 3. The taxpayers countered with a motion for summary judgment which the District Court granted at the same time that it denied the Government's motion to dismiss. (Pet. 23, 29.)

The judgment of the District Court was predicated on the theory that Section 322(b)(1)[1] related to over-

[1] That court erroneously discussed the corresponding provisions of Section 6511 of the 1954 Code. (Pet. 23, 26-27.) As appears from Section 7851(a)(6)(A) of the Code, the provisions of Section 322(b)(1) are applicable with respect to taxes imposed by the 1939 Code.

payments of tax; that when the taxes in question were paid they did not constitute an "overpayment" because "As the law stood at the time of its payment, it was a legal tax and the amount paid was the correct amount." (Pet. 28.) Hence, the District Court concluded that Section 322(b)(1) had no application. (Pet. 29.)

The District Court further reasoned that Section 117(q) "changed the nature of money received by the taxpayer from that of ordinary income to that of capital gain"; that the right of action to recover taxes paid on the former (ordinary income) basis accrued to taxpayers on June 29, 1956, when Section 117(q) became law; that the case therefore fell within the general six-year period of limitation provided in 28 U.S.C. 2401(a), *supra*, p. 4; and that since the action was commenced on August 23, 1957, it was well within that six-year period. (Pet. 28-29.)

The Court of Appeals, relying upon the authority of *Tobin* v. *United States*, 264 F. 2d 845 (C. A. 5), (Pet. 31), which involved the same factual situation and the same legal questions, reversed, holding that Section 117(q) of the Internal Revenue Code of 1939 did not establish a new claim, but merely confirmed the already existing right to seek a timely refund and that, under the facts and controling law, there is no basis for taxpayers' theory that the ordinary statute limiting claims and suits for tax refunds is not applicable.

ARGUMENT

The decision of the court below is correct. There is no direct conflict of decisions, and no other basis warranting review by this Court.

The court below and the Fifth Circuit (*Tobin* v. *United States*, *supra*), the only two appellate courts which have considered the questions presented herein, are in agreement that Section 117(q), *supra*, pp. 2-3, which provides that a transfer of certain property rights to a patent shall be deemed to be a sale or exchange of a capital asset, neither created a claim against the United States entitling a taxpayer to the benefit of the general six-year statute of limitations (28 U.S.C. 2401(a), *supra*, p. 4), nor impliedly extended the three-year period of limitation for filing claims for refunds prescribed in Section 322(b)(1) of the Internal Revenue Code of 1954 (*supra*, p. 3).

Section 117(q) as added to the 1939 Code by the Act of June 29, 1956, is identical with Section 1235 of the Internal Revenue Code of 1954. The legislative history of these sections demonstrates that by their provisions Congress was not creating a new cause of action or right, but was merely codifying the weight of the existing case law on the subject, though contrary to the then position of the Commissioner. The legislative and administrative history resulting in the enactment of Section 117(q) is set forth in *Philbrick* v. *Commissioner*, 27 T.C. 346, 354-355. In brief that history shows that following the decision of the Tax Court in 1946 in *Myers* v. *Commissioner*, 6 T.C. 258, holding that annual payments or royalties received by an in-

ventor under a state of facts similar to those here involved were long-term capital gain, the Commissioner first acquiesced,[2] then (1950) reconsidered and ruled[3] that royalties received for taxable years beginning after May 31, 1950 (the effective date of Mim. 6490), would be regarded as ordinary income. The action resulted in the renewal of litigation concerning the proper tax treatment of such royalties. Thereafter, in drafting the Internal Revenue Code of 1954, Congress incorporated the provisions of Section 1235, the purpose of which was to obviate the uncertainty caused by the Commissioner's ruling. (Mim. 6490.) Section 1235, however, applied only to payments received in taxable years beginning after December 31, 1953, and ending after August 16, 1954 (the date of enactment of the 1954 Code).[4] Shortly after Section 1235 became law, the Commissioner announced[5] that with respect to payments received in taxable years beginning after May 31, 1950, and before January 1, 1954, he would continue to adhere to the position stated in the mimeograph. The result was that payments under the same contract received in taxable years begining either before May 31, 1950, or after December 31, 1953, would, on the one hand, be treated as capital gain, while payments received in the intervening period would be

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[2] 1946-1 Cum. Bull. 3.

[3] Mim. 6490, 1950-1 Cum. Bull. 9.

[4] See Section 7851(a)(1)(A), Internal Revenue Code of 1954.

[5] Rev. Rul. 55-58, 1955-1 Cum. Bull. 97.

treated as ordinary income. It was to remedy this situation that Congress enacted Section 117(q).

Nothing in the language of Section 117(q) nor its legislative history even suggests that Congress intended to create a new cause of action giving rise to a claim against the United States, which either was outside the scope of the internal revenue laws or extended by implication the time for filing a refund claim as provided in the Internal Revenue Code. Cf. *United States* v. *Hvoslef*, 237 U. S. 1; *Thacher* v. *United States*, 149 Fed. 902 (Mass.); and *United States* v. *Shipley*, 197 Fed. 265 (C.A. 3d), with *Verckler* v. *United States*, 170 F. Supp. 802 (C. Cls.).

The action here is one to recover internal revenue taxes alleged to have been erroneously collected. In this respect it is noted that in their complaint the taxpayers asserted jurisdiction in the District Court under the provisions of 28 U.S.C. 1346(a)(1) (*supra*, p. 4), which covers suits "for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, * * *." In actions of this nature, the specific requirements and time limitations provided in the internal revenue laws for the filing of claims govern[6] and the general six-year period of limitations provided in 28 U.S.C. 2401(a), merely places an outside limit on the period within which such suits may be initiated. *United States* v. *A. S. Kreider Co.*, 313 U.S. 443.

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[6] *United States* v. *Felt & Tarrant Co.*, 283 U.S. 269; *United States* v. *Michel*, 282 U.S. 656; *Rock Island &c. R.R.* v. *United States*, 254 U.S. 141.

As indicated by decisions prior to the enactment of Section 117(q)[7] the taxpayers here, like the taxpayers in those cases, were in no way precluded, prior to the passage of Section 117(q), from filing timely claims for refund under Section 322(b)(1) nor from instituting suit on the cause of action involved in the merits of taxpayers' claim that the gain was capital and not ordinary income. See *Jones* v. *Liberty Glass Co.*, 332 U.S. 524, 531, 534 and *Kavanagh* v. *Noble*, 332 U.S. 535, 538.

On the question of whether Section 117(q) impliedly extended the three-year statute of limitations provided in Section 322(b)(1), there is no direct conflict of authority. The cases cited by taxpayer (Pet. 10) involved different statutory provision and different situations. Thus, *Hollander* v. *United States*,

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[7] Cf. *Kavanagh* v. *Evans*, 188 F. 2d 234 (C.A. 6); *Allen* v. *Werner*, 190 F. 2d 840 (C.A. 5); *United States* v. *Carruthers*, 219 F. 2d 21 (C.A. 9); *Massey* v. *United States*, 226 F. 2d 724 (C.A. 7); *Hofferbert* v. *Briggs*, 178 F. 2d 743 (C.A. 4); *Storm* v. *United States*, 243 F. 2d [illegible] (C.A. 5); *Commissioner* v. *Celanese Corp.*, 140 F. 2d 339 (C.A. D.C.); *Commissioner* v. *Hopkinson*, 126 F. 2d 406 (C.A. 2); *Kronner* v. *United States*, 110 F. Supp. 730 (C. Cls.); *Myers* v. *Commissioner*, 6 T.C. 258; with *Gregg* v. *Commissioner*, 203 F. 2d 954 (C.A. 10); *Cleveland Graphite Bronze Co.* v. *Commissioner*, 177 F. 2d 200 (C.A. 6); *Bloch* v. *United States*, 200 F. 2d 63 (C.A. 2); and *Broderick* v. *Neale*, 201 F. 2d 621 (C.A. 10).

The decisions in *Allen* v. *Werner*, *supra*, *Bloch* v. *United States*, *supra*, and *Broderick* v. *Neale*, *supra*, pass upon the tax consequences of transactions, *i.e.*, whether license or sale, and are not in conflict with the decision herein or in *Tobin* v. *United States*, *supra*, contrary to taxpayer's contention. (Pet. 7-8.)

248 F. 2d 247 (C.A. 2), involved remedial legislation designed to provide retroactive tax relief for estates of decedents under circumstances where, as the Second Circuit said, Congress must have known that the application of the bar of Sections 910 and 911 of the Internal Revenue Code of 1939 upon the filing of refund claims and instituting suits for recovery would probably have nullified the relief proposed.[8] As pointed out above, this is not the situation here. Again, prior to the passage of the amending Act involved in *Verckler* v. *United States*, *supra*, which also was designed to provide tax relief to the estates of certain decedents, no cause of action existed and a taxpayer did not have a right to claim and receive a refund of the tax.[9] The cases of *Rosenman* v. *United States*, 323 U.S. 658, and *United States* v. *Dubuque Packing Co.*, 233 F. 2d 453 (C.A. 8), merely stand for the proposition that moneys received by the Government in advance of the assessment of taxes and deposited in a suspense account do not constitute payment of taxes for the purpose of starting the statutory period for filing a claim for refund. The other cases cited by taxpayer (Pet. 9-11) are plainly without application and certainly present no conflict.

As already noted, Section 117(q) was added to the 1939 Code by Section 1 of the Act of June 29, 1956,

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[8] But see the dissenting opinion of Judge Clark.

[9] The decisions of the Court of Claims in *Siegel* v. *United States*, 18 F. Supp. 771; *Detroit Trust Co.* v. *United States*, 18 F. Supp. 776, and *Morgan* v. *United States*, 18 F. Supp. 1017, with which taxpayers also assert conflict (Pet. 7) were decided on the same principle.

supra. Section 2 of the same Act, effecting a disparate amendment, expressly provided for the extension by one year of the period of limitations for filing refund claims. The sharp contrast in this respect between Sections 1 and 2 of the same Act clearly indicates that had Congress intended to extend the bar of the statute of limitations with respect to Section 1, it would have done so.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submited,

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JULY, 1959.

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